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AUTHOR Goldsmith, Scott; And Others
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ABSTRACT

The State of Alaska spends 75% of its operating revenues on transfer payments to individuals and local governments and on salaries and benefits of state workers. By the year 2000, dwindling petroleum revenues will result in a projected $1 billion gap between state income and spending, but inflation and growing population could widen that gap to $1.3 billion. This paper presents profiles of Alaska's 10 largest transfer programs, examining past, current, and projected costs; program beneficiaries; economic effects; and possible alternatives. These programs are the: (1) Permanent Fund Dividend Program; (2) Longevity Bonus Program; (3) Power Cost Equalization Program; (4) School Foundation Program, which pays 60-75% of school operating costs; (5) School Debt Reimbursement Program, which pays 80% of the debt service on bonds for school facilities construction; (6) Pupil Transportation Aid, which reimburses school districts for most student transportation costs; (7) Revenue Sharing Program; (8) Municipal Assistance Program; (9) Public Assistance Programs; and (10) Medical Assistance Payments. Details are also provided on state payroll and employee benefits. Alaska spends much more per capita than any other state, partly because of its special environmental and demographic features, but mostly because of: (1) its unique programs; (2) higher spending for traditional government services; and (3) significantly higher spending on state workers, even after allowing for Alaska's higher living costs. This paper contains numerous graphics and charts to illustrate the discussion. (SV)

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BIG TICKET SPENDING:

TRANSFERS AND LABOR COSTS

ISER FISCAL POLICY PAPERS
No. 4, March 1990

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ISER
FISCAL POLICY PAPERS
No. 4, March 1990
Institute of Social and Economic Research University of Alaska Anchorage

Big Ticket Spending: Transfers and Labor Costs

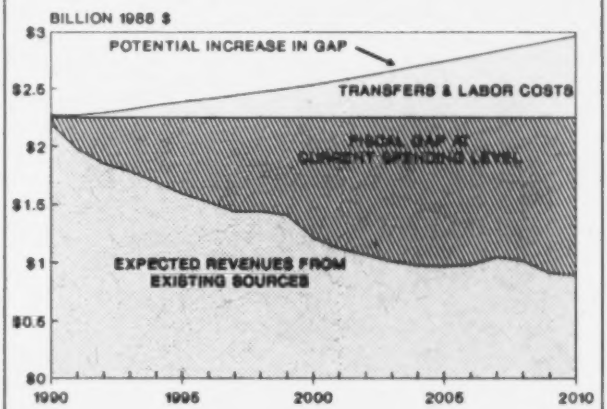
The State of Alaska spends 75 percent of its operating revenues in two ways: transferring money to individuals and local governments, and paying salaries and benefits of state workers. Anyone considering how the state should cut its budget has to understand where most of the money goes—and to recognize that transfer payments and labor costs tend to grow with population and inflation.

Petroleum revenues, which have paid for most of state government in the past decade, are on a decline that will continue over the next two decades as production from the huge Prudhoe Bay field drops. Dwindling petroleum revenues could leave a $1 billion hole in the state budget by 2000, as Figure 1 shows.

But that projected gap is based on the *current* level of spending. If in fact transfer payments and labor costs grow with population and inflation, the gap between revenues and spending could easily be as large as $1.3 billion by 2000—or 30 percent larger than we have projected in earlier Fiscal Policy Papers. Growing transfer payments and labor costs would contribute about equally to that increased gap.

This paper profiles state transfer (grant and claim) programs and labor costs (including both payroll and benefits), which together account for three of every four dollars the state spends on general operating expenses. (See the box on page 2.) This analysis is a complement to Fiscal Policy Paper 2, in which we examined why Alaska spends much more per capita than any other state. In that paper we reported that while special Alaska conditions—huge area, small population, harsh climate, for instance—do increase government costs in Alaska, those factors account for a relatively modest share of Alaska's higher spending. More important are the realities that (1) Alaska has a number of unique programs; (2) Alaska spends more for traditional government services; and (3) Alaska pays its average employee significantly more, even if we take into account Alaska's higher living costs.

Figure 1. Potential of Growing Transfers and Labor Costs To Increase Fiscal Gap*



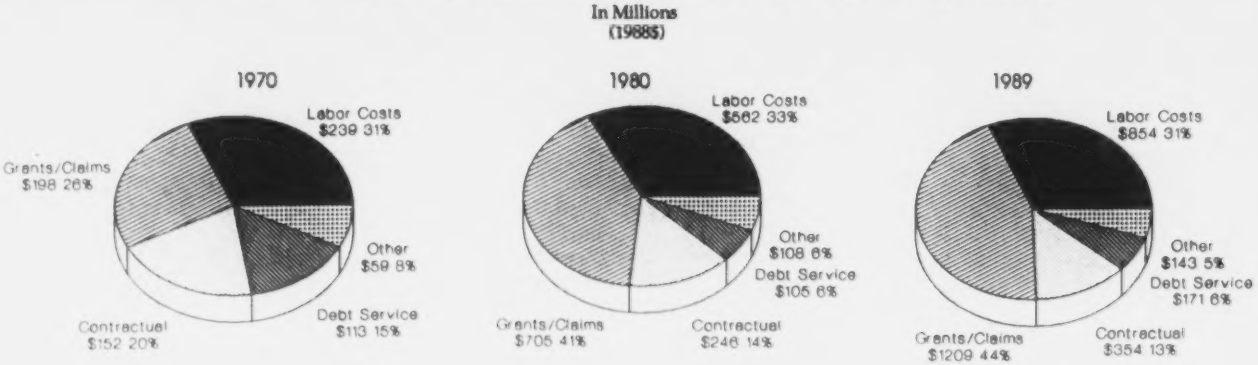
*Projected at the current level of state general fund expenditures. Revenues include oil settlement estimate.

This is the fourth in a series of ISER Fiscal Policy Papers examining aspects of state government revenues and spending. We intend these papers to focus the attention of state officials and of Alaskans in general on the serious budget crisis we face, and on the necessity for dealing with it soon.

The authors of this paper are Scott Goldsmith, professor of economics at ISER; Jay Hogan, former director of the Alaska Division of Budget Review; and Lee Gorsuch, ISER director. Linda Leask is the series editor. Tracey Bradford and Teresa Hull prepared the graphics.

The ISER Fiscal Policy Papers series is financed by a grant from ARCO Alaska.

Measuring Transfers and Labor Costs in the Operating Budget



To measure the importance of transfers (grants and claims) and labor costs (payroll and benefits) in the state budget we use total operating expenditures as the base. This definition excludes Permanent Fund earnings as well as capital expenditures but includes operating expenditures from restricted funds, the most important of which are federal funds. (The fiscal gap calculation in Figure 1 is just for the state unrestricted General Fund. It excludes programs paid for with restricted funds.)

The pie charts above show that grants and claims and labor costs made up most of the operating budget in 1970, 1980, and 1989. But while the labor cost share held fairly steady at around 30 to 33 percent, the grants and claims portion grew from 26 percent in 1970 to 44 percent by 1989. Because of that big increase in the share of grants and claims, transfers and labor costs increased from 57 percent of the operating budget in 1970 to 75 percent in 1989.

Contractual, the next largest part of the budget, includes not only contracts the state issues for services but also some grants to local jurisdictions; these are very difficult to sort out. The percentage of the budget dedicated to debt service (this category also includes some miscellaneous expenses) dropped from 15 percent in 1970 to 6 percent by 1989; that happened because the rest of the budget grew so quickly in the 1980s and because the state paid cash for capital projects. The remaining "other" category includes travel, commodities, and equipment.

This paper examines how the two biggest categories of spending affect the state operating budget. If Alaska is to balance its budget in the coming years, state officials will have to consider ways of re-structuring transfer programs and holding down employee costs.

We profile the 10 largest state transfer programs and state payroll and benefits in single-page summaries that make up most of this paper. Lack of space prevents us from including all the unique Alaska programs (some of which are not transfer programs) and the many smaller transfer programs. We conclude by looking at the implications of our analysis for state officials dealing with declining revenues.

Largest State Transfer Programs

We profile nine transfer programs paid for with general fund money, and one—the Permanent Fund dividend program—paid for with earnings of the Permanent Fund. These nine general fund programs paid individuals and local governments $970 million in 1989, and the Permanent Fund dividend program paid individuals another $440 million. Some Alaskans would argue that we shouldn't include the dividend program in a discussion of general state spending, because it is not paid for with general fund money. We include it because the Permanent Fund dividend program represents very substantial spending and it is state-funded. The legislature can if it chooses use the earnings of the Permanent Fund for other purposes. The dividend program is *not*, however, included in our calculation of the fiscal gap in Figure 1.

We want to emphasize that within the broad category of "transfer programs" the individual programs are vastly different and have to be considered very differently. The 10 transfer programs we profile (which account for 83 percent of all transfer payments) fall into three types:

Programs that provide income to Alaskans, are unique to the state, and are funded at the discretion of the legislature: These programs are the Permanent Fund dividend program, the Longevity Bonus program, and the Power Cost Equalization program. These programs make payments to individual Alaskans without regard to income. The legislature could eliminate them

Adjusting for Inflation

All figures in this paper are in 1988 dollars, except as noted. That adjustment eliminates the effects of inflation so we can assess real changes in spending over time.

without affecting traditional government functions.

Programs that aid local governments and school districts: These programs are Revenue Sharing, Municipal Assistance, School Foundation, School Debt Reimbursement, and Pupil Transportation. Alaska will have to decide how much local aid to provide based on the needs of local governments, their own sources of revenues, and other factors.

All state governments provide some aid to their local governments. How much they provide depends partly on decisions about which level of government should provide the services and which level should collect the taxes. There are advantages in collecting taxes at the state level and spending them at the local level; for instance, if the state collects the taxes it can equalize them across jurisdictions.

Programs that help needy Alaskans: These are the public assistance and the medical assistance programs for Alaskans with low incomes, few assets, or disabilities. The public assistance programs include Aid to Families with Dependent Children (AFDC) and Adult Public Assistance (APA). The chief medical assistance program is Medicaid. Some assistance programs are paid for entirely by the state but the largest are mandated by the federal government and funded jointly by the federal and state governments. The state's ability to change these programs is consequently more limited than it is for other transfer programs. The potential for change is also more limited because, unlike the unique Alaska transfer programs that make payments regardless of income, these welfare and medical assistance programs provide basic income and services for needy Alaskans.

Pages 4 through 13 profile the state's largest transfer programs, summarizing past, current, and projected costs, program beneficiaries, and major program changes. The profiles also reveal which programs were established only in the 1980s, after the state began collecting big petroleum revenues; which are based on need; and how each broadly compares with programs in other states.

(Text continues on Page 15)

Five Alternatives: The Range of Future Program Costs

A number of alternatives exist for changing state transfer programs to cut or control costs in the future. The 1990 legislature has already moved to contain future state costs for construction of district schools by eliminating the open-ended reimbursement program for school bond indebtedness and replacing it with a school construction fund (see page 8). It also increased the required length of residence for individuals to qualify for the Permanent Fund dividend and the Longevity Bonus programs (see pages 4 and 5).

For any of the 10 transfer programs we profile, state officials would have to consider alternatives specific to each program before making major changes. We do not analyze all the specific alternatives that might exist for each program but rather show the potential *range* of costs for each program by 2000 through five standard alternatives. These five standard alternatives measure potential changes relative to current expenditures. They estimate future costs if the program continued to provide the same level of service per beneficiary; if the program were eliminated; and if several intermediate changes were made. We're not advocating these standard alternatives for any program. The five standard alternatives we use (with some exceptions for specific programs) are:

Maintain Real Expenditures Per Recipient: Keep real expenditures per recipient at same level by allowing costs to rise with increasing number of beneficiaries and with inflation.

Cap Expenditures Per Recipient: Hold future payments to each recipient at the current nominal level (costs rise with growing number of beneficiaries but not with inflation).

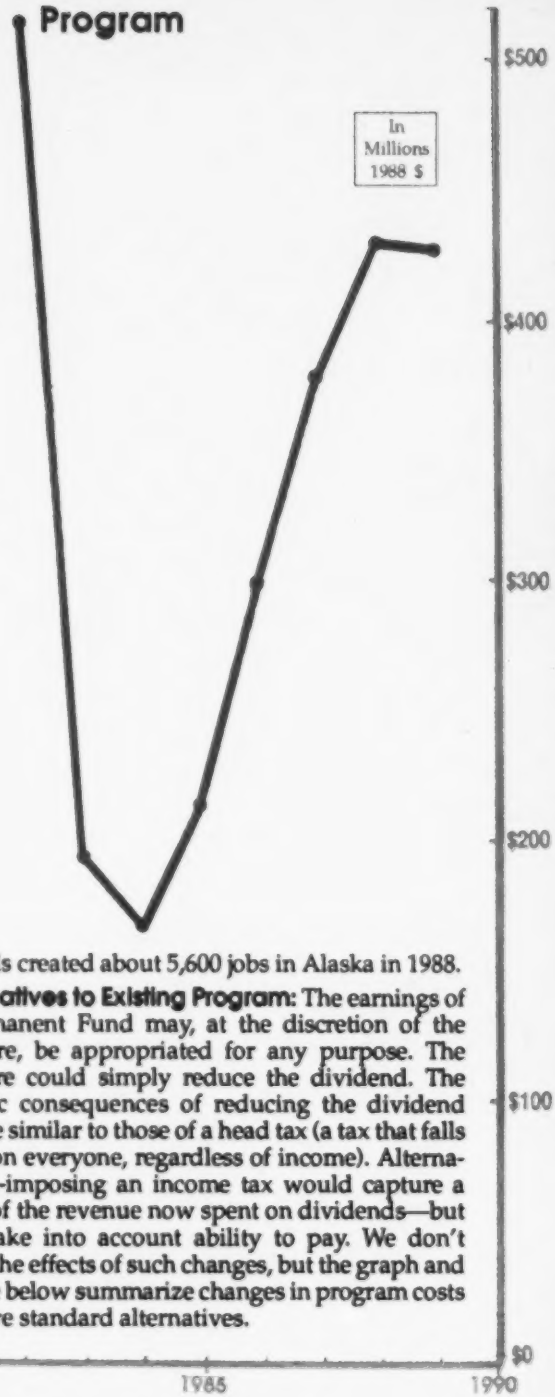
Cap Expenditures at 1989 Level: Hold total program expenditures at the 1989 nominal level (costs not increased for either more beneficiaries or inflation).

Target Most Needy: Narrow the number of recipients for each program by targeting the most needy (as defined for each program).

Eliminate Program: Do away with the program entirely.

Permanent Fund Dividend Program

Expend. 1989:$438 mill. (Perm. Fund. earnings)
Growth 1980-89 (1988$): $424 mill.
Expend. per capita (1988$): 1980-0; 1989-$794
Expend. cuts from peak: No cuts
Beneficiaries: 1980-0 ; 1989-503,000 (est.)
Existed before 1980: No
Based on need: No
Comparable programs, Other U.S.: None



Description: Makes annual payments to all eligible Alaskans using approximately 50 percent of the earnings of the Permanent Fund. The 1989 dividend of $873 will go to about 503,000 Alaskans for a total of $438 million. The state recently increased the program residency requirement from six months to two years.

Purpose: Pay individuals a direct share of oil wealth; give Alaskans an incentive to keep Permanent Fund intact. Originally the program was to have paid higher dividends to longer-term residents; that restriction was declared unconstitutional in 1982.

Special Features: The federal government would reduce welfare and medical assistance payments of recipients but the state reimburses the federal government for these payments. In 1989 "hold harmless" payments for this program were about $10 million.

Program Changes:

1980—Program established, with amount of dividend tied to length of residence.

1982—Following a U.S. Supreme Court ruling, program modified so all residents of at least six months would receive equal dividends.

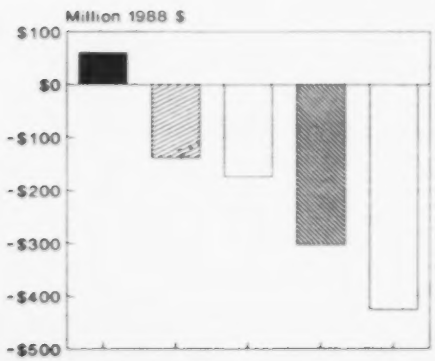
1990—Residence requirement increased to two years.

Effects of Program on Typical Beneficiary: The dividend increases average personal income by about 4 percent statewide. In some areas of rural Alaska dividend payments make up more than 10 percent of personal income.

Economic Effects of Program: Spending of dividends created about 5,600 jobs in Alaska in 1988.

Alternatives to Existing Program: The earnings of the Permanent Fund may, at the discretion of the legislature, be appropriated for any purpose. The legislature could simply reduce the dividend. The economic consequences of reducing the dividend would be similar to those of a head tax (a tax that falls equally on everyone, regardless of income). Alternatively, re-imposing an income tax would capture a portion of the revenue now spent on dividends—but would take into account ability to pay. We don't analyze the effects of such changes, but the graph and narrative below summarize changes in program costs under five standard alternatives.

Possible Change in Program Cost By 2000



General Remarks: Legislature appropriates 50% of Permanent Fund earnings; appropriation divided among eligible population.

Maintain Real Expend. Per Recipient: Costs $60 million higher, if dividend grows with population and inflation.

Cap at 1989 Expend. Per Recipient: Costs reduced $138 million, if expenditures not increased for inflation but the number of recipients grows

Cap at 1989 Expenditure: Costs reduced $174 million, if payments not increased either for inflation or population growth

Target Most Needy: Costs reduced $303 million, if dividends distributed only to the 25% of population with lowest incomes

Eliminate Program: Costs reduced $424 million

Longevity Bonus Program

Expend. 1989: $53 mill. (Gen. Fund)
Growth 1980-89 (1988 $): +$35 mill. (207%)
Expend. per capita (1988$): 1980-$40; 1989-$97
Expend. cuts from peak: No cuts
Beneficiaries: 1980-7,000; 1989-18,000
Existed before 1980: Yes
Based on need: No
Comparable programs, Other U.S.: None

Description: Pays $250 per month to all Alaskans over 65 who have lived in the state at least two years. About 18,000 Alaskans, or 3 percent of the total population, received payments in 1989.

Purpose: At first limited to those over 65 who had lived in Alaska at least 25 years and were here at the time of statehood; the "longevity" bonus was intended to share oil wealth with pioneers and help them stay in Alaska. In 1984 the courts declared the residence requirement unconstitutional, so the state expanded the program.

Special Features: The federal government would reduce welfare and medical assistance payments of eligible recipients but the state reimburses the federal government for these payments.In 1989 "hold-harmless" payments for this program were $ 4.4 million.

Program Changes:

1972— Program established with $100 payments per month.

1976-1981-Payments periodically increased.

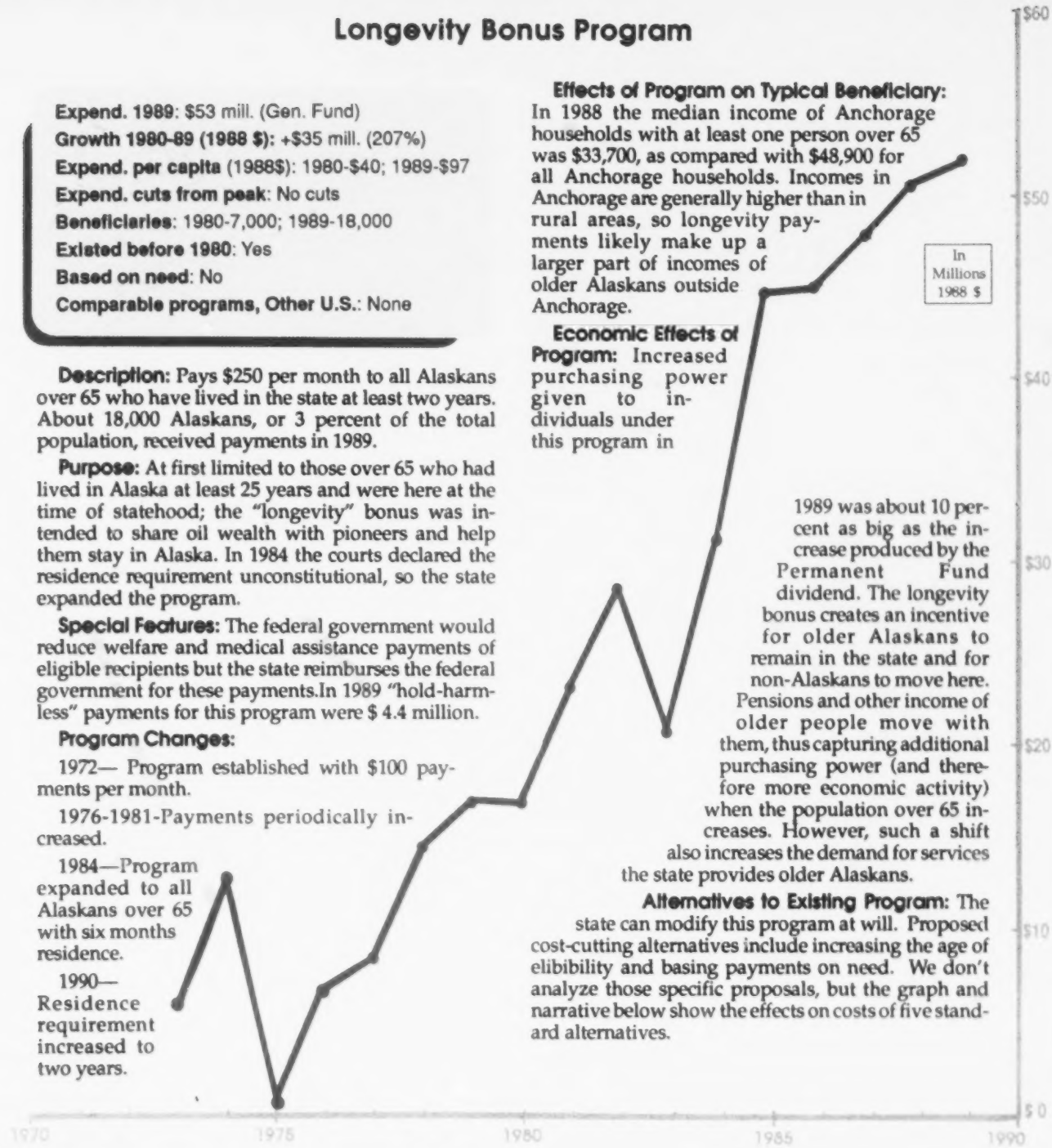
1984—Program expanded to all Alaskans over 65 with six months residence.

1990— Residence requirement increased to two years.

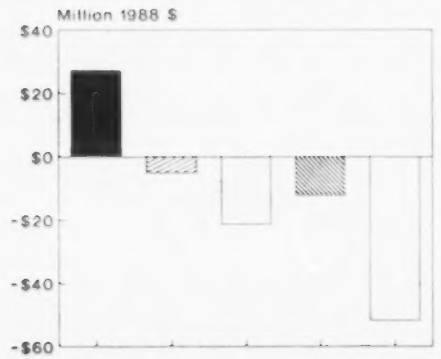
Effects of Program on Typical Beneficiary: In 1988 the median income of Anchorage households with at least one person over 65 was $33,700, as compared with $48,900 for all Anchorage households. Incomes in Anchorage are generally higher than in rural areas, so longevity payments likely make up a larger part of incomes of older Alaskans outside Anchorage.

Economic Effects of Program: Increased purchasing power given to individuals under this program in 1989 was about 10 percent as big as the increase produced by the Permanent Fund dividend. The longevity bonus creates an incentive for older Alaskans to remain in the state and for non-Alaskans to move here. Pensions and other income of older people move with them, thus capturing additional purchasing power (and therefore more economic activity) when the population over 65 increases. However, such a shift also increases the demand for services the state provides older Alaskans.

Alternatives to Existing Program: The state can modify this program at will. Proposed cost-cutting alternatives include increasing the age of elibibility and basing payments on need. We don't analyze those specific proposals, but the graph and narrative below show the effects on costs of five standard alternatives.



Possible Change in Program Cost By 2000



General Remarks: Appropriation is fixed amount per recipient, with no automatic increase for inflation.

Maintain Real Expend. Per Recipient: Costs $27 million higher, if payments increased with population and inflation

Cap at 1989 Expend. Per Recipient: Costs reduced $5 million, if payments not adjusted for inflation but number of recipients grows

Cap at 1989 Expenditure: Costs reduced $21 million, if expenditures not increased for inflation or population growth

Target Most Needy: Costs reduced $12 million if definition changed to eliminate 50% of those currently eligible

Eliminate Program: Costs reduced $52 million

Power Cost Equalization Program

Expend. 1989: $18 mill. (Gen. Fund)
Growth 1980-89 (1988$): +$18 mill.
Expend. per capita (1988$): 1980-0; 1989-$33
Expend. cuts from peak: No cuts
Beneficiaries: 1980-0; 1989: 60,000
Existed before 1980: No
Based on Need: No
Comparable programs, Other U.S.: None

Description: Subsidizes electricity bills for rural customers, based on cost of power but without regard to income. Payments are made to rural utilities, which then reduce customers' bills (including commercial and public consumers) on use up to 750 kwh per month. The program excludes utilities in or near urban areas and in communities where electricity from state hydroelectric projects is available.

Purpose: To reduce electricity bills in rural areas.

Special Features: Proponents describe this program as the rural counterpart to the state-subsidized hydroelectric projects built in the early 1980s and to the railbelt energy fund—which is a reserve account set aside several years ago to help pay for future electrical generation along the railbelt from the Kenai Peninsula to Fairbanks. (How the railbelt energy fund will actually be used is still an open question, however.)

Program Changes:

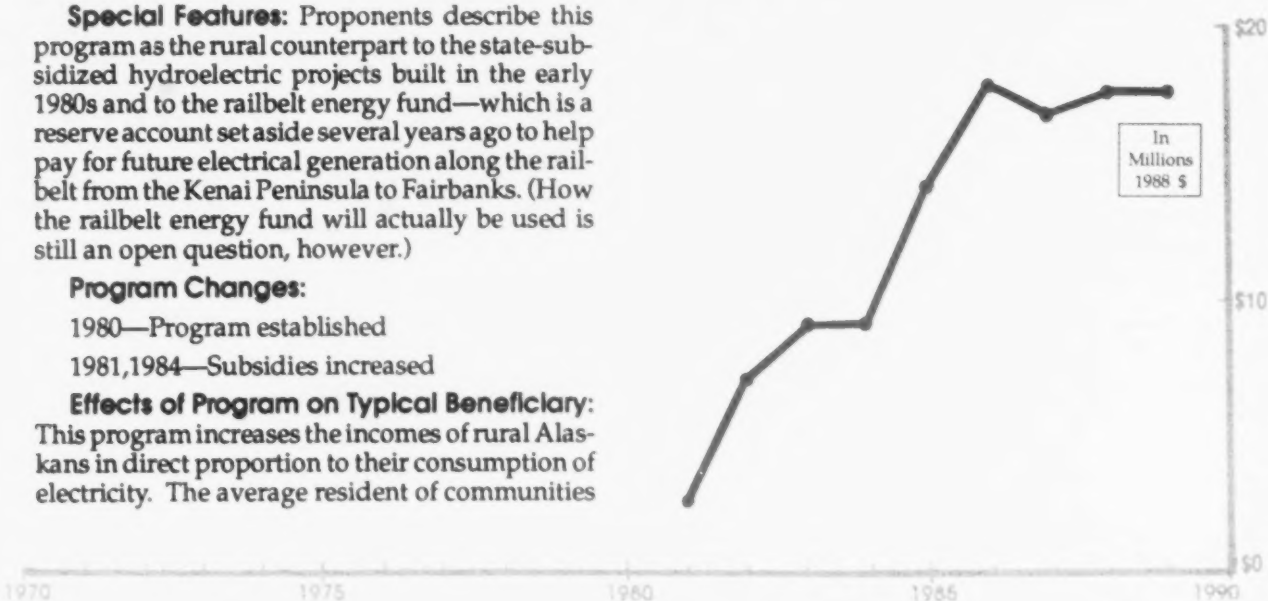
1980—Program established

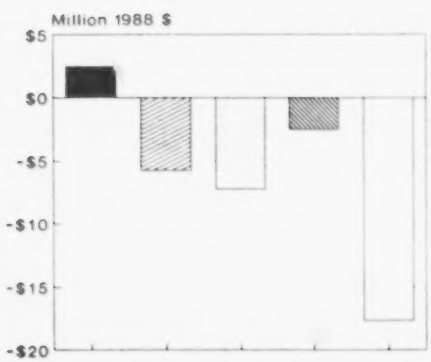
1981,1984—Subsidies increased

Effects of Program on Typical Beneficiary: This program increases the incomes of rural Alaskans in direct proportion to their consumption of electricity. The average resident of communities served by this program received a benefit of $275 in 1989, which reduced the average rate for a kwh of electricity by more than 50%.

Economic Effects of Program: This program not only increases personal income but also use of electricity in communities served. By subsidizing costs for consumers it promotes inefficient use, and by paying utilities based on cost it creates no incentive for more efficient generation.

Alternatives to Existing Program: Costs under this program could go significantly higher if customers took full advantage of the 750 kwh per month subsidy it allows; only 45% of eligible kwh were consumed in 1989. Lawmakers could redesign the program formula to create incentives to reduce use of high-cost electricity and to generate electricity more efficiently. Conversion to a fixed rebate per customer would be one method. We don't analyze specific changes, but the graph and narrative below describe the effects on program costs of five standard alternatives.





Possible Changes in Program Cost by 2000

General Remarks: No automatic inflation increase; appropriation prorated by formula.

Maintain Real Expend. Per Recipient: Costs $2.5 million higher, if increased with inflation and population; could increase faster if customers used full subsidy (see text above)

Cap at 1989 Expend per Recipient: Costs reduced $ 6 million, if not increased for inflation but number of recipients grows

Cap at 1989 Expenditure: Costs reduced $ 7 million, if costs not increased for inflation or population growth

Target Most Needy: Costs reduced $ 2.5 million, if definition changed to eliminate 25% of those currently eligible

Eliminate Program: Costs reduced $ 18 million

School Foundation Program

Expend. 1989: $457 mill. (Gen. Fund 93%; Fed. 5%, Other 2%)

Growth 1980-89 (1988$): +$237 mill. (116%)

Expend. per capita (1988$): 1980- $486; 1989- $827

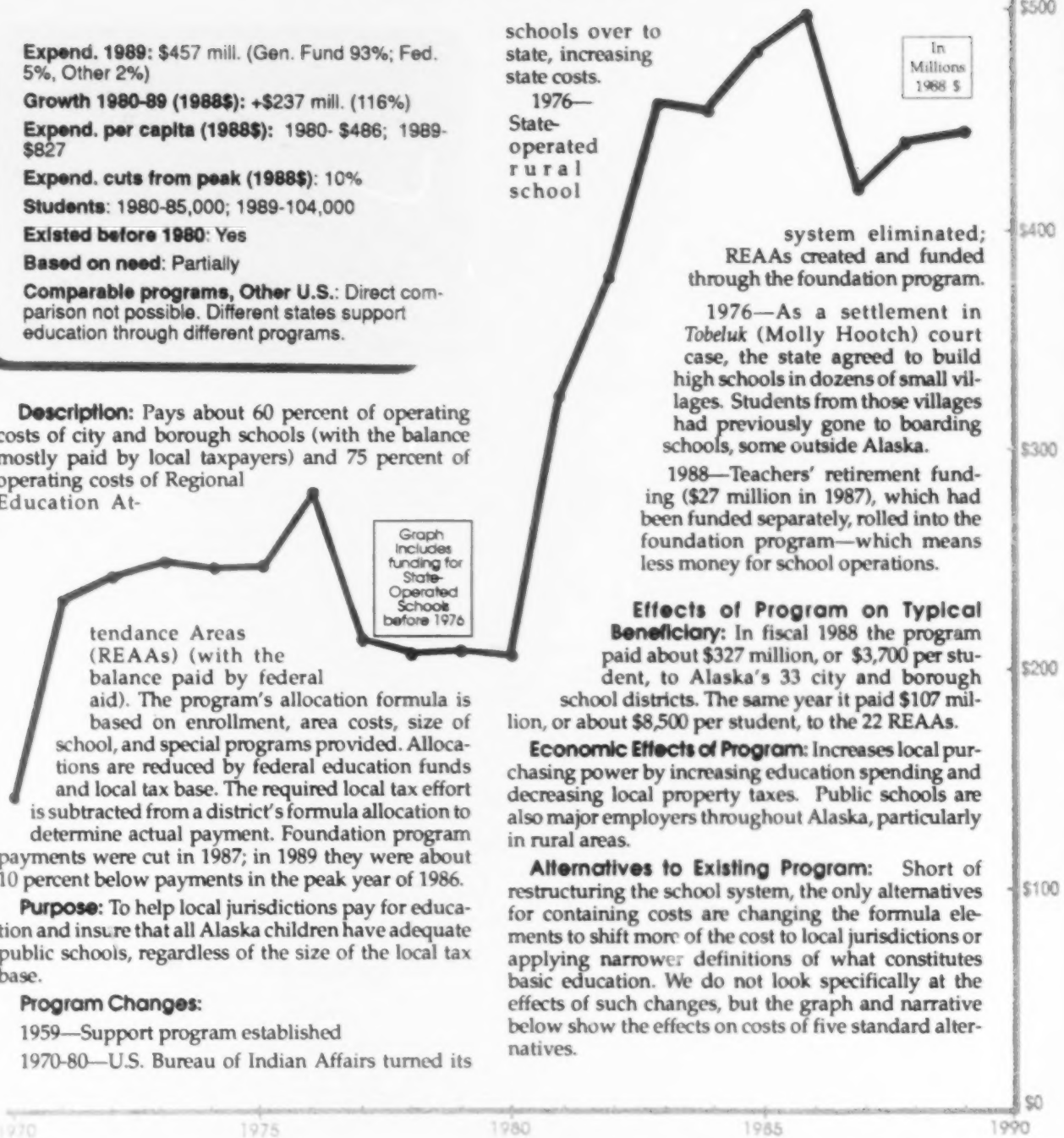
Expend. cuts from peak (1988$): 10%

Students: 1980-85,000; 1989-104,000

Existed before 1980: Yes

Based on need: Partially

Comparable programs, Other U.S.: Direct comparison not possible. Different states support education through different programs.



Description: Pays about 60 percent of operating costs of city and borough schools (with the balance mostly paid by local taxpayers) and 75 percent of operating costs of Regional Education Attendance Areas (REAAs) (with the balance paid by federal aid). The program's allocation formula is based on enrollment, area costs, size of school, and special programs provided. Allocations are reduced by federal education funds and local tax base. The required local tax effort is subtracted from a district's formula allocation to determine actual payment. Foundation program payments were cut in 1987; in 1989 they were about 10 percent below payments in the peak year of 1986.

Purpose: To help local jurisdictions pay for education and insure that all Alaska children have adequate public schools, regardless of the size of the local tax base.

Program Changes:

1959—Support program established

1970-80—U.S. Bureau of Indian Affairs turned its schools over to state, increasing state costs.

1976—State-operated rural school system eliminated; REAAs created and funded through the foundation program.

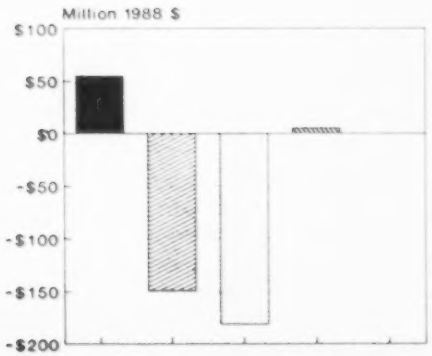
1976—As a settlement in *Tobeluk* (Molly Hootch) court case, the state agreed to build high schools in dozens of small villages. Students from those villages had previously gone to boarding schools, some outside Alaska.

1988—Teachers' retirement funding ($27 million in 1987), which had been funded separately, rolled into the foundation program—which means less money for school operations.

Effects of Program on Typical Beneficiary: In fiscal 1988 the program paid about $327 million, or $3,700 per student, to Alaska's 33 city and borough school districts. The same year it paid $107 million, or about $8,500 per student, to the 22 REAAs.

Economic Effects of Program: Increases local purchasing power by increasing education spending and decreasing local property taxes. Public schools are also major employers throughout Alaska, particularly in rural areas.

Alternatives to Existing Program: Short of restructuring the school system, the only alternatives for containing costs are changing the formula elements to shift more of the cost to local jurisdictions or applying narrower definitions of what constitutes basic education. We do not look specifically at the effects of such changes, but the graph and narrative below show the effects on costs of five standard alternatives.



Possible Change in Program Cost By 2000

General Remarks: No automatic inflation increase; appropriation is prorated by formula.

Maintain Real Expend. Per Recipient: Costs $55 million higher, if increased with inflation and growing number of students

Cap at 1989 Expend. Per Student: Costs reduced $149 million, if increased for number of students but not for inflation

Cap at 1989 Expenditure: Costs reduced $181 million, if not increased for either inflation or growing number of students

Target Most Needy: Costs $5 million higher, if 1989 expenditures cut 10% by reducing aid to districts most able to pay

Eliminate Program: Not applicable because the state constitution requires provision of basic education

School Debt Reimbursement Program

Expend. 1989: $109 mill. (Gen. Fund)
Growth 1980-89 (1988$): +$75 mill. (249%)
Expend. per capita (1988$): 1980- $72; 1989- $197
Expend. cuts from peak: Yes (see text)
Beneficiaries: 1980-360,000; 1989-455,000
Existed before 1980: Yes
Based on need: No
Comparable programs, Other U.S.: None

Description: The state currently pays 80 percent of the debt service on bonds city and borough districts sell to finance school construction. Under legislation passed in 1990, future state aid for school construction will come from a new school construction fund, to be a part of the capital rather than the operating budget and to be administered by the Department of Education.

Purpose: To help school districts pay for new schools and ease the burden of those schools on local taxpayers.

Special Features: For 20 years this program was an open-ended commitment of state funds. It has been described as the urban counterpart to the state practice of paying for rural school construction through the capital budget.

Program Changes:

1970—Reimbursement program established, at 50 percent of local debt service payments.

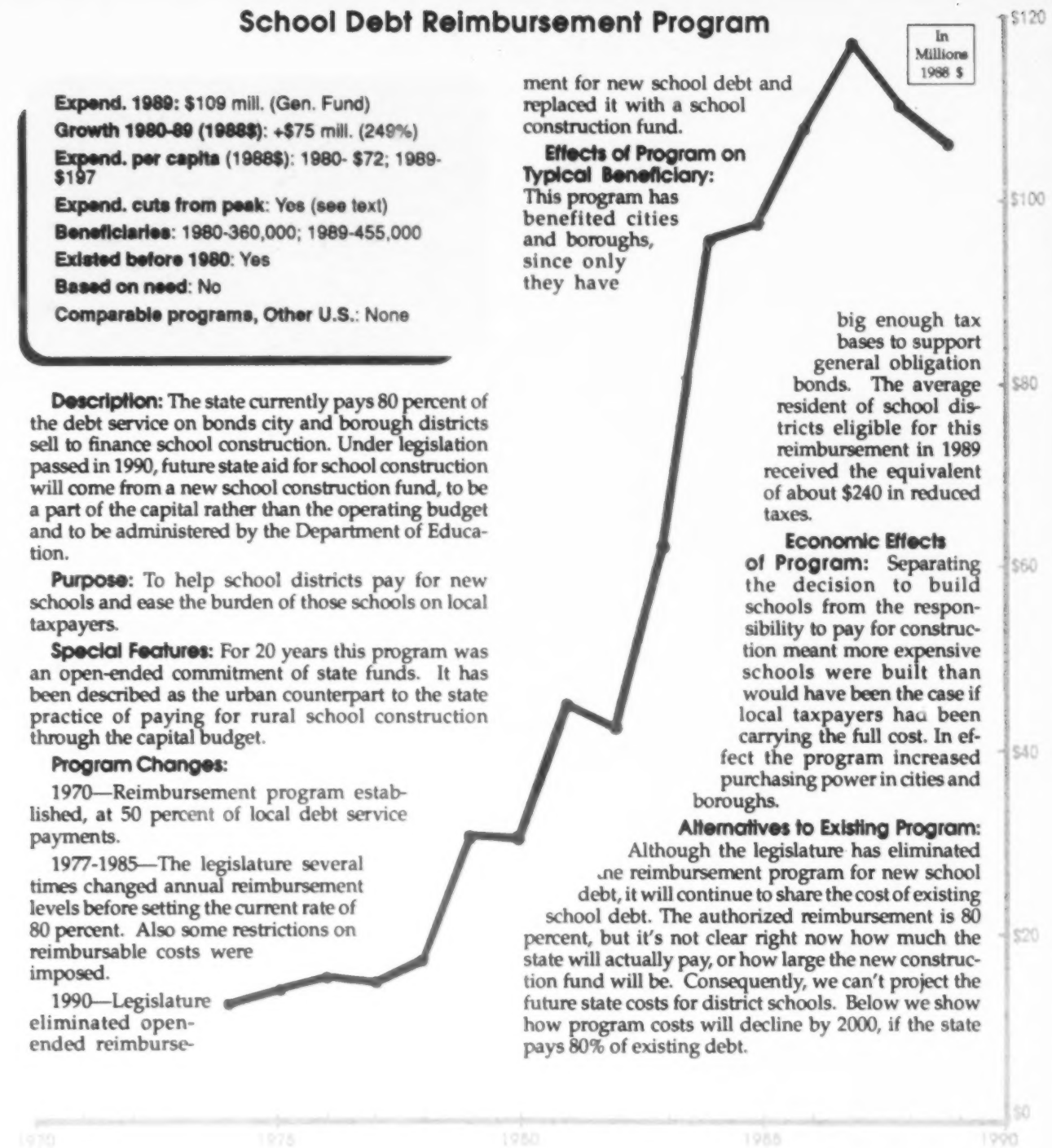
1977-1985—The legislature several times changed annual reimbursement levels before setting the current rate of 80 percent. Also some restrictions on reimbursable costs were imposed.

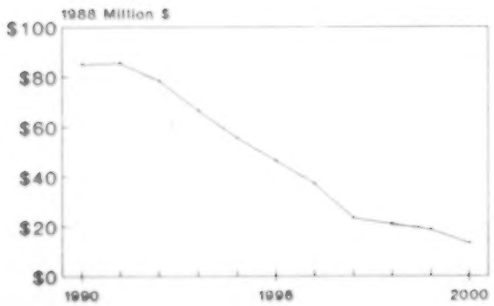
1990—Legislature eliminated open-ended reimbursement for new school debt and replaced it with a school construction fund.

Effects of Program on Typical Beneficiary: This program has benefited cities and boroughs, since only they have big enough tax bases to support general obligation bonds. The average resident of school districts eligible for this reimbursement in 1989 received the equivalent of about $240 in reduced taxes.

Economic Effects of Program: Separating the decision to build schools from the responsibility to pay for construction meant more expensive schools were built than would have been the case if local taxpayers had been carrying the full cost. In effect the program increased purchasing power in cities and boroughs.

Alternatives to Existing Program: Although the legislature has eliminated the reimbursement program for new school debt, it will continue to share the cost of existing school debt. The authorized reimbursement is 80 percent, but it's not clear right now how much the state will actually pay, or how large the new construction fund will be. Consequently, we can't project the future state costs for district schools. Below we show how program costs will decline by 2000, if the state pays 80% of existing debt.





Program Phaseout at 80 Percent State Reimbursement

The $70 million drop in debt by 2000 will not be all savings to the state, because part of it will be replaced by as-yet undetermined spending from a school construction fund. The governor has proposed $50 million for that fund for fiscal 1991, but the legislature has not yet approved an amount.

Pupil Transportation Aid

Expend. 1989: $25 mill. (Gen. Fund)
Growth 1980-89 (1988$): +$5 mill. (25%)
Expend. per capita (1988$): 1980-$46; 1989-$45
Expend. cuts from peak (1988$): 4%
Students Transported: 45,000
Existed before 1980: Yes
Based on need: Yes
Comparable programs, Other U.S.: Direct comparison not possible. Different states support education through different programs.

Description: Reimburses school districts for most costs of transporting students to and from school on most routes; also pays up to 90 percent of the purchase price of school buses. Payments are adjusted annually for cost-of-living increases.

Purpose: State law requires school districts to transport students who are not within defined walking distances of school.

This program reduces transportation costs for districts (and the burden on local taxpayers).

Program Changes:

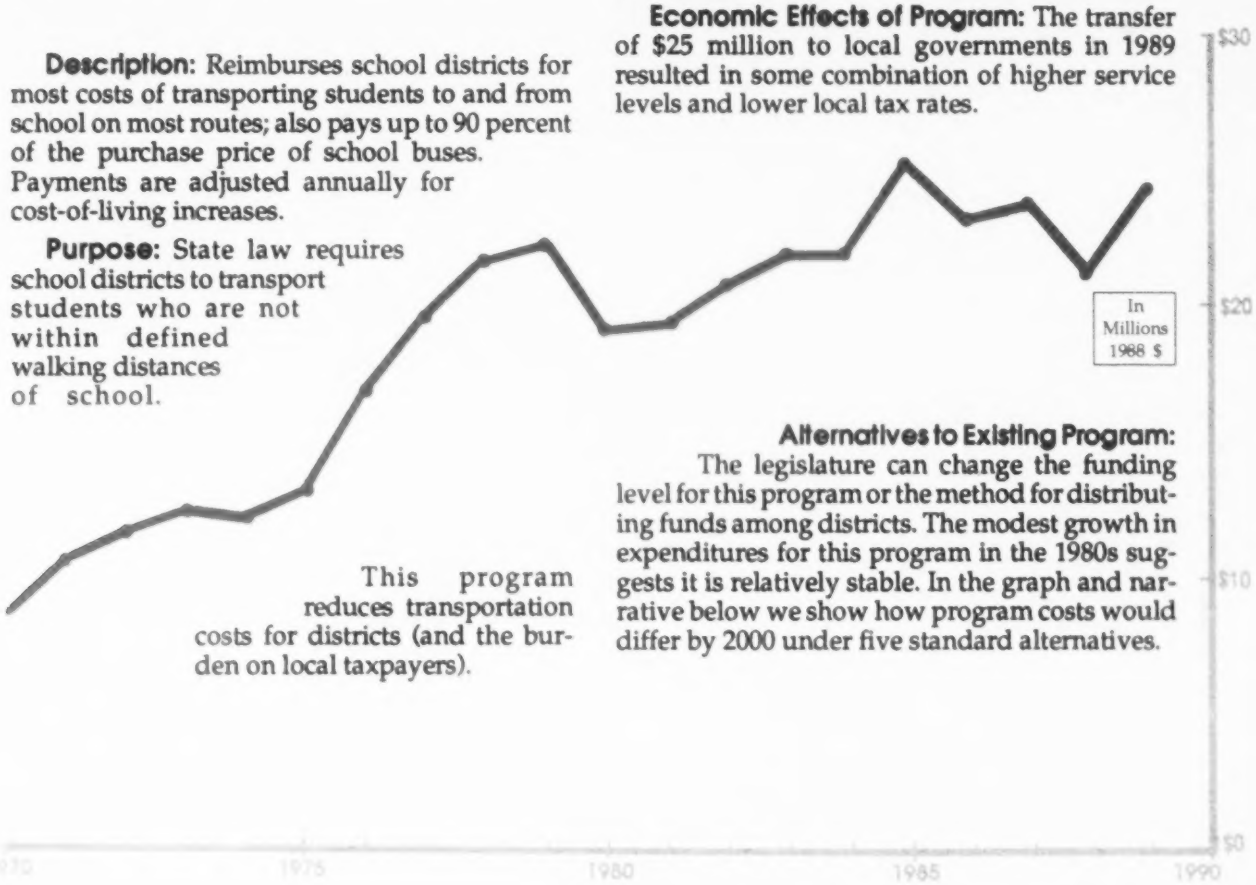
1966—Program established for public schools.

1972—Program expanded to cover private schools, if routes are similar to those used by public schools.

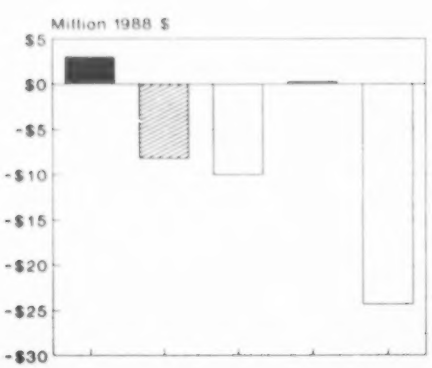
Special Features: In other states transportation costs are sometimes incorporated into foundation grants for education.

Effects of Program on Typical Beneficiary: The average cost for each student transported in school districts served by this program was about $550 in 1989.

Economic Effects of Program: The transfer of $25 million to local governments in 1989 resulted in some combination of higher service levels and lower local tax rates.



Alternatives to Existing Program: The legislature can change the funding level for this program or the method for distributing funds among districts. The modest growth in expenditures for this program in the 1980s suggests it is relatively stable. In the graph and narrative below we show how program costs would differ by 2000 under five standard alternatives.



Possible Changes in Program Cost by 2000

General Remarks: Payments adjusted for inflation. Appropriation prorated.

Maintain Real Expend. per Recipient: Costs increase $3 million, if increased with population and inflation

Cap at 1989 Expend per Recipient: Costs reduced $ 8 million, if increased for number of students but not for inflation

Cap at 1989 Expenditure: Cost reduced $ 10 million, if not increased either for inflation or more students

Target Most Needy: Costs virtually unchanged, if definition changed to eliminate 10% of those currently eligible

Eliminate Program: Costs reduced $ 24 million

Revenue Sharing Program

Expend. 1989: $41 mill. (Gen. Fund)
Growth 1980-89 (1988$): +$6 mill. (17%)
Expend. per capita (1988$): 1980-$80; 1989-$74
Expend. cuts from peak (1988$): 32%
Beneficiaries: 1980-420,000; 1989-535,000
Existed before 1980: Yes
Based on need: Partially
Comparable programs, Other U.S.: Similar

Description: Makes per capita categorical and tax equalization grants to 153 municipalities and 102 unincorporated places. Each local jurisdiction receives a minimum amount, independent of population; an amount based on services provided; and an amount based on local tax effort. Payments are also adjusted for regional cost differences. Revenue sharing payments have declined steadily since their peak in 1985.

Purpose: Initially established to encourage municipalities to provide more local services. Since 1980, the program has also been used to assure each municipality at least a minimum amount of shared revenues—$25,000 in 1989.

Program Changes:

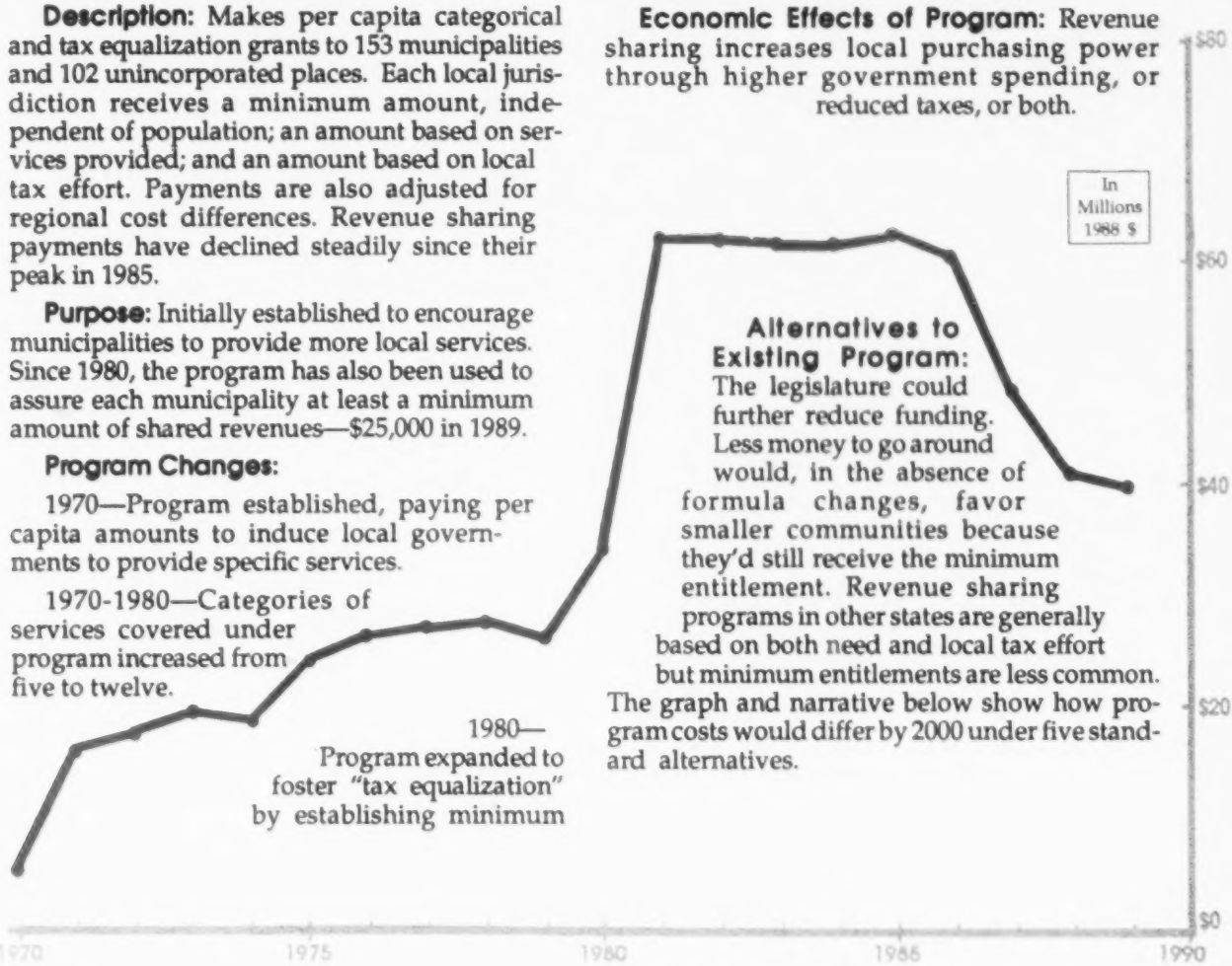
1970—Program established, paying per capita amounts to induce local governments to provide specific services.

1970-1980—Categories of services covered under program increased from five to twelve.

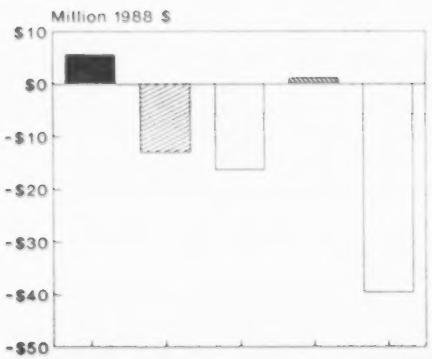
1980—Program expanded to foster "tax equalization" by establishing minimum aid level and basing allocations partially on need.

Effects of Program on Typical Beneficiary: All Alaskans benefit from this program, because all communities receive a share. In 1989 the average community received the equivalent of $76 per resident under the program. Because of the program's minimum allotment and formula allocation, payments varied considerably among communities, with smaller places generally receiving higher per capita amounts. For example, Bettles received $642 per capita in 1989 while Fairbanks received $45 per capita.

Economic Effects of Program: Revenue sharing increases local purchasing power through higher government spending, or reduced taxes, or both.



Alternatives to Existing Program: The legislature could further reduce funding. Less money to go around would, in the absence of formula changes, favor smaller communities because they'd still receive the minimum entitlement. Revenue sharing programs in other states are generally based on both need and local tax effort but minimum entitlements are less common. The graph and narrative below show how program costs would differ by 2000 under five standard alternatives.



Possible Changes in Program Cost by 2000

General Remarks: No automatic inflation increase; appropriation prorated by formula.

Maintain Real Expend. Per Recipient: Costs increase $ 6 million, if increased with inflation and population

Cap at 1989 Expend per Recipient: Costs reduced $ 13 million, if payments increased for population growth but not inflation

Cap at 1989 Expenditure: Cost reduced $ 16 million, if payments not increased for either population growth or inflation

Target Most Needy: Costs increase $ 1 million, if local matching funds today replaced 10% of program costs

Eliminate Program: Costs reduced $ 39 million

Municipal Assistance Program

Expend 1989: $56 mill. (Gen. Fund)
Growth 1980-89 (1988$):+ $47 mill.(225%)
Expend. per capita (1988$): 1980-0 ; 1989-$102
Expend. cuts from peak (1988$): 31%
Beneficiaries: 1980-0;1989-520,000
Existed before 1980: No (see text)
Based on need: No
Comparable programs, Other U.S.: Probably none

Description: Makes equal per capita grants to all organized municipalities in the state. The base of the program is $10.8 million (the amount formerly shared with local governments from the gross business receipts tax under the shared taxes program), which is distributed as the former tax revenues were. Amounts above that base are distributed among organized municipalities on a per capita basis. Statutorily the legislature can appropriate 30 percent of corporate income tax receipts (which are mainly from petroleum) but in practice appropriations have been set by the legislature independent of taxes collected. Payments under this program have declined more than 30 percent from the peak in the mid-1980s.

Purpose: To distribute oil revenues to municipalities and to help reduce local taxes.

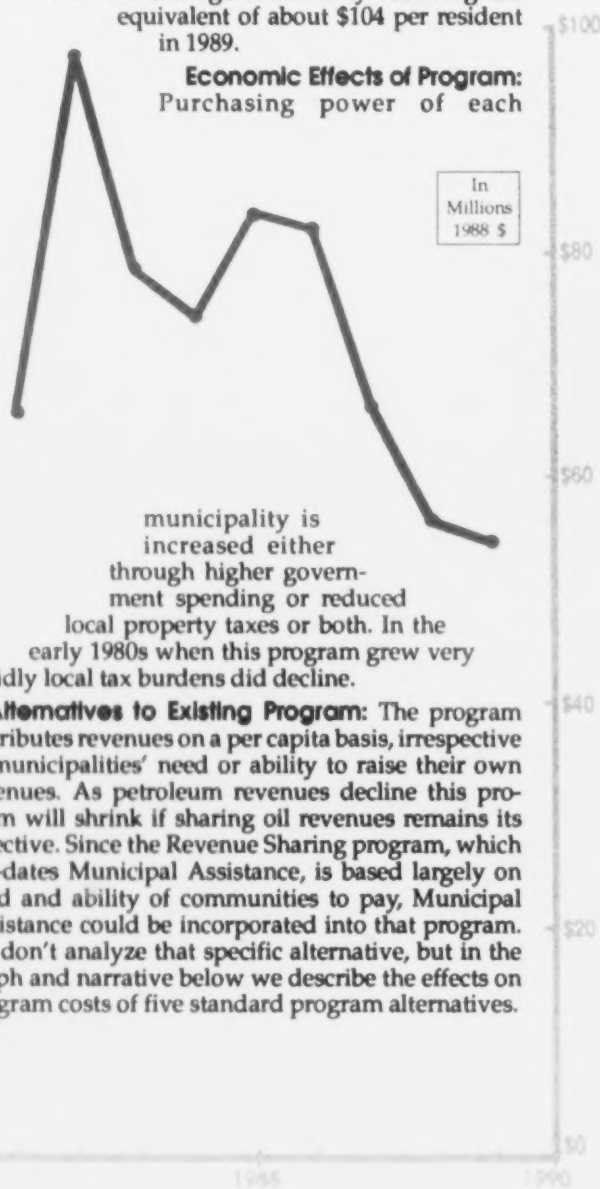
Program Changes:

1978—Program established as part of shared taxes program, to be funded with 10 percent of state corporate income taxes; no substantial payment made until fiscal 1981.

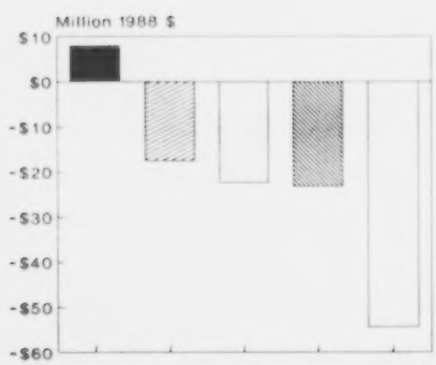
1981—Program separated from shared taxes and base increased to 30 percent of corporate income taxes after a change in tax law substantially reduced corporate income taxes.

Effects of Program on Typical Beneficiary: All residents of organized municipalities (97 percent of the state population) benefit from this program, with the average community receiving the equivalent of about $104 per resident in 1989.

Economic Effects of Program: Purchasing power of each municipality is increased either through higher government spending or reduced local property taxes or both. In the early 1980s when this program grew very rapidly local tax burdens did decline.



Alternatives to Existing Program: The program distributes revenues on a per capita basis, irrespective of municipalities' need or ability to raise their own revenues. As petroleum revenues decline this program will shrink if sharing oil revenues remains its objective. Since the Revenue Sharing program, which pre-dates Municipal Assistance, is based largely on need and ability of communities to pay, Municipal Assistance could be incorporated into that program. We don't analyze that specific alternative, but in the graph and narrative below we describe the effects on program costs of five standard program alternatives.



Possible Changes in Program Cost by 2000

General Remarks: No automatic inflation increase; appropriation prorated by formula.

Maintain Real Expend. Per Recipient: Costs increase $ 8 million, if increased with population and inflation

Cap at 1989 Expend per Recipient: Costs reduced $ 18 million, if payments increased for population growth but not inflation

Cap at 1989 Expenditure: Costs reduced $ 22 million, if not increased for either inflation or population growth

Target Most Needy: Costs reduced $ 23 million, if program reduced to 50% of 1989 per capita level

Eliminate Program: Costs reduced $ 54 million

Public Assistance Programs

Expend. 1989: $84 million (Gen. Fund 57%; Fed. 32%; Other 9%)

Growth 1980-89 (1988$): +$36 mill. (81%)

Expend. per capita(1988$), 1980-$107; 1989-$151

Expend. cuts from peak: No cuts

Beneficiaries: 1980-19,000; 1989-26,000

Existed before 1980: Yes

Based on need: Yes

Comparable programs, Other U.S.: Similar, but Ak. payments maintained by unique "hold harmless" provision (see text).

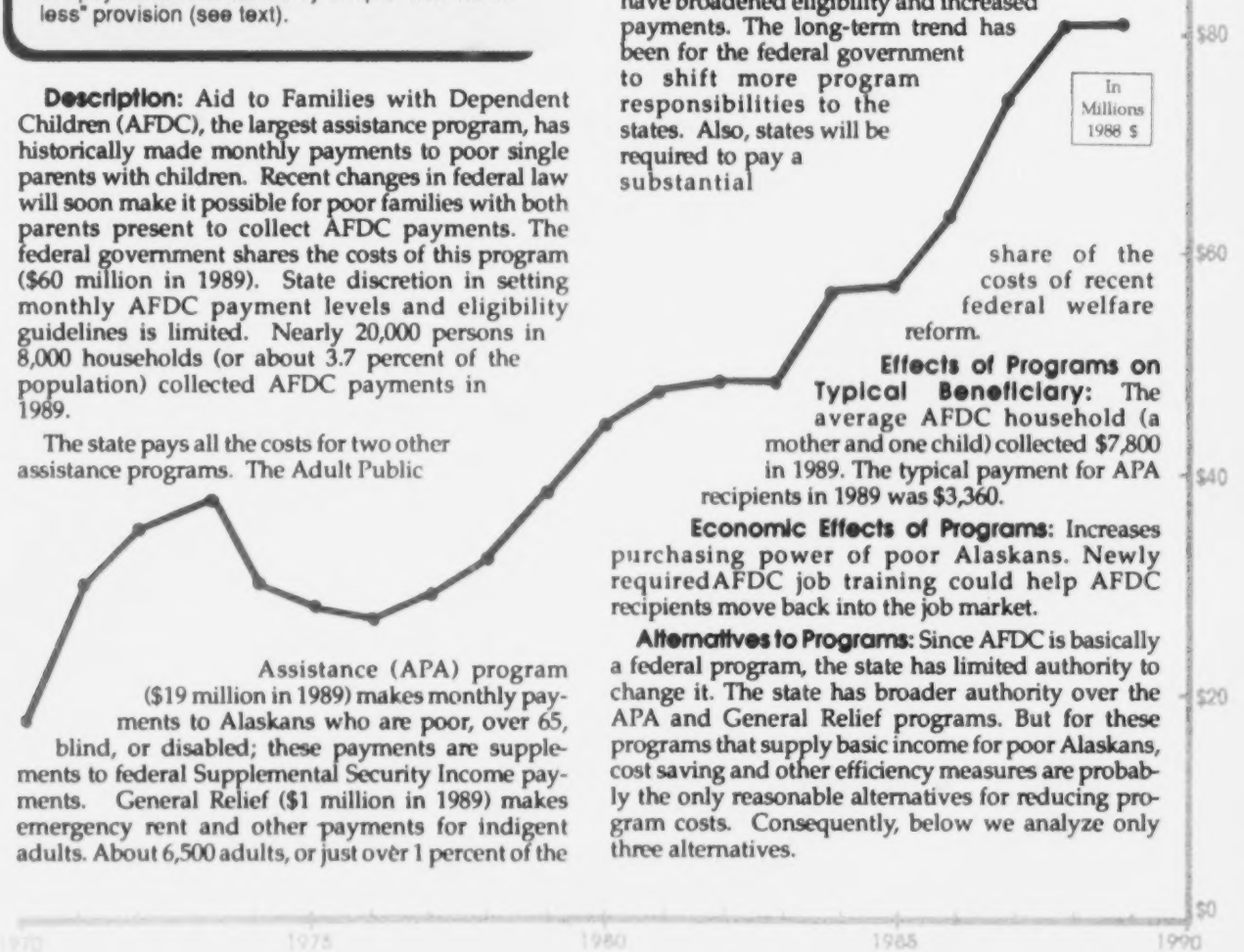
Description: Aid to Families with Dependent Children (AFDC), the largest assistance program, has historically made monthly payments to poor single parents with children. Recent changes in federal law will soon make it possible for poor families with both parents present to collect AFDC payments. The federal government shares the costs of this program ($60 million in 1989). State discretion in setting monthly AFDC payment levels and eligibility guidelines is limited. Nearly 20,000 persons in 8,000 households (or about 3.7 percent of the population) collected AFDC payments in 1989.

The state pays all the costs for two other assistance programs. The Adult Public Assistance (APA) program ($19 million in 1989) makes monthly payments to Alaskans who are poor, over 65, blind, or disabled; these payments are supplements to federal Supplemental Security Income payments. General Relief ($1 million in 1989) makes emergency rent and other payments for indigent adults. About 6,500 adults, or just over 1 percent of the population, received APA payments in a typical month in 1989.

Purpose: To help Alaskans who otherwise have little or no income.

Special Features: Program costs include "hold harmless" payments the state makes to the federal government on behalf of recipients of Longevity Bonuses or Permanent Fund dividends. These payments keep public assistance recipients from losing their benefits.

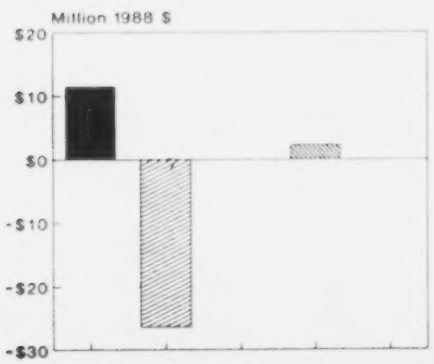
Program Changes: A number of changes in federal and state law over the years have broadened eligibility and increased payments. The long-term trend has been for the federal government to shift more program responsibilities to the states. Also, states will be required to pay a substantial share of the costs of recent federal welfare reform.



Effects of Programs on Typical Beneficiary: The average AFDC household (a mother and one child) collected $7,800 in 1989. The typical payment for APA recipients in 1989 was $3,360.

Economic Effects of Programs: Increases purchasing power of poor Alaskans. Newly requiredAFDC job training could help AFDC recipients move back into the job market.

Alternatives to Programs: Since AFDC is basically a federal program, the state has limited authority to change it. The state has broader authority over the APA and General Relief programs. But for these programs that supply basic income for poor Alaskans, cost saving and other efficiency measures are probably the only reasonable alternatives for reducing program costs. Consequently, below we analyze only three alternatives.



Possible Change in Program Cost By 2000

General Remarks: Automatic cost-of-living adjustment could be eliminated.

Maintain Real Expend. Per Recipient: Costs $12 million higher, if payments increased with inflation and population, and if the federal government maintains its current share of costs; otherwise state costs could be much higher

Cap at 1989 Expend. Per Recipient: Costs reduced $26 million, if payments increased for population growth but not inflation

Reduce Recipients: Costs $2 million higher, if the circumstances of 10% of those currently eligible could be improved so they didn't need public assistance

Medical Assistance Payments

Expend. 1989: $129 mill. (Gen Fund 49%; Fed. 51%)

Growth 1980-89 (1988$): +$75 mill (148%)

Expend. per capita (In 1988$) 1980-$120;1989-$234

Expend cuts from peak: No cuts

Beneficiaries: 1980-N/A; 1985-19,900; 1989 37,500

Existed before 1980: Yes

Based on need: Yes

Comparable programs, Other U.S.: Similar, but Alaska payments maintained by unique "hold harmless" provision.

Description: Medicaid and General Relief Medical pay medical costs for eligible low-income and disabled Alaskans. The federal Indian Health Service provides medical services to Natives.

Medicaid ($113 million in 1989) accounts for about 90 percent of payments. Alaskans whose low incomes, limited assets, or disabilities qualify them for Adult Public Assistance (APA) or Aid to Families with Dependent Children (AFDC) also qualify for Medicaid. The federal and state governments split the costs of Medicaid roughly 50-50.

General Relief Medical ($8 million in 1989) is paid for entirely through the state general fund and covers only urgent medical costs of unemployed adults who can't qualify for other aid.

Purpose: To provide medical care for low-income single parents, children, disabled persons, and the elderly.

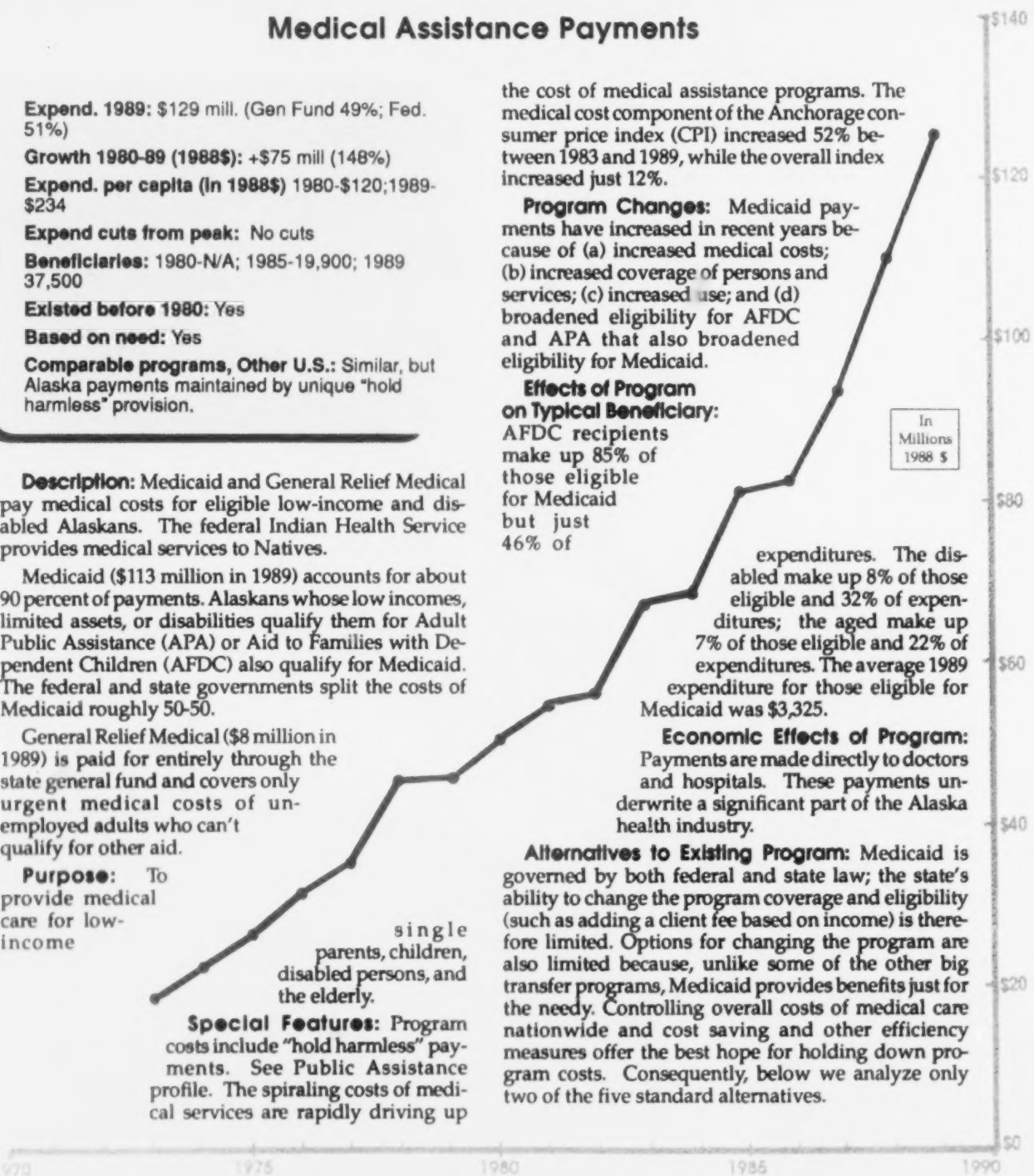
Special Features: Program costs include "hold harmless" payments. See Public Assistance profile. The spiraling costs of medical services are rapidly driving up the cost of medical assistance programs. The medical cost component of the Anchorage consumer price index (CPI) increased 52% between 1983 and 1989, while the overall index increased just 12%.

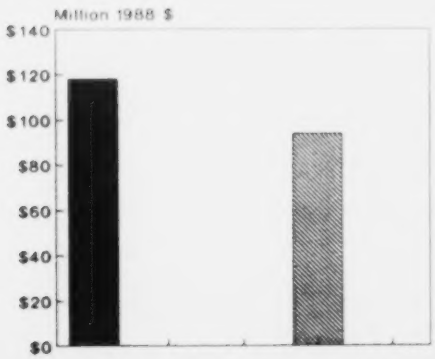
Program Changes: Medicaid payments have increased in recent years because of (a) increased medical costs; (b) increased coverage of persons and services; (c) increased use; and (d) broadened eligibility for AFDC and APA that also broadened eligibility for Medicaid.

Effects of Program on Typical Beneficiary: AFDC recipients make up 85% of those eligible for Medicaid but just 46% of expenditures. The disabled make up 8% of those eligible and 32% of expenditures; the aged make up 7% of those eligible and 22% of expenditures. The average 1989 expenditure for those eligible for Medicaid was $3,325.

Economic Effects of Program: Payments are made directly to doctors and hospitals. These payments underwrite a significant part of the Alaska health industry.

Alternatives to Existing Program: Medicaid is governed by both federal and state law; the state's ability to change the program coverage and eligibility (such as adding a client fee based on income) is therefore limited. Options for changing the program are also limited because, unlike some of the other big transfer programs, Medicaid provides benefits just for the needy. Controlling overall costs of medical care nationwide and cost saving and other efficiency measures offer the best hope for holding down program costs. Consequently, below we analyze only two of the five standard alternatives.





Possible Change in Program Cost By 2000

General Remarks: Program is driven mainly by rising medical costs as reflected in the "medical care" portion of the consumer price index.

Maintain Real Expend. Per Recipient: Costs $118 million higher. If costs increased by medical cost inflation and population growth and if the federal government maintains its share of medical costs

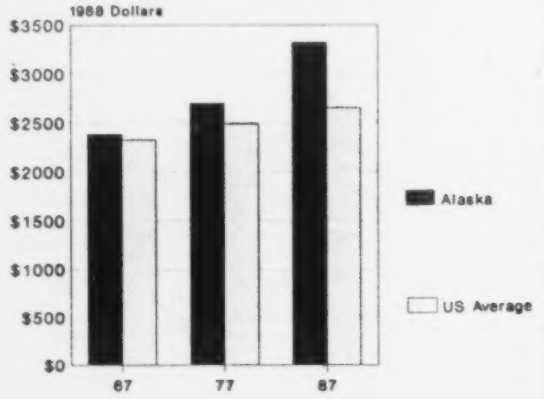
Reduce Recipients: Costs $94 million higher if circumstances of 10% of those currently eligible could be improved so they no longer needed assistance

State Payroll and Benefits

State Labor Costs and Employment

Sources: Legislative Finance Division, Office of Management and Budget

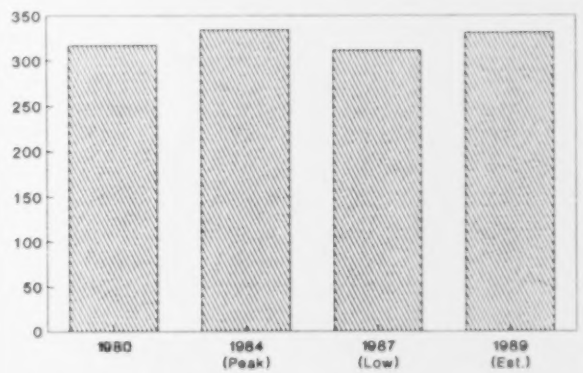
Average State Government Wage*



	67	77	87
Alaska	$2378	$2693	$3319
US Average	$2322	$2485	$2652
Ratio	1.02	1.08	1.25

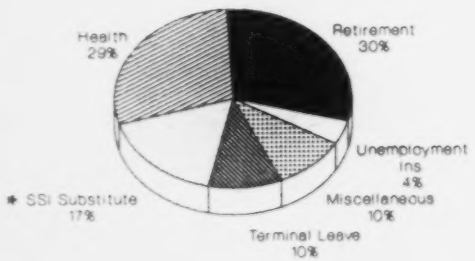
*Average October earnings, full-time employees; excludes benefits.
Source: U.S. Department of Commerce.
Note: U.S. averages are inflated by Alaska COLA.

Jobs per 10,000 Population



Sources: See note above

State Benefits By Type
1989



* In 1980 State employees opted out of the Social Security system and the state substituted an alternative plan.

Factors Increasing State Employment

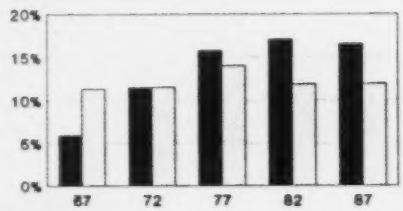
- 1. Population growth increased program beneficiaries
- 2. Existing programs augmented
- 3. New programs added
- 4. Regulatory and management requirements increased

State Employee Health Insurance Premiums

1985 - $ 2,618; 1989 - $ 5,184; 1990 - $ 4,615

Source: Task Force, Health Care Cost Containment

Contributions to Retirement Plans
As a Percentage of State and Local Payroll
Alaska and U.S. Average



	67	72	77	82	87
AK EMP CONTRIBUTION	2.5%	4.2%	4.7%	4.5%	5.6%
US EMP CONTRIBUTION	4.4%	4.3%	4.2%	3.5%	3.4%
AK GOVT CONTRIBUTION	3.3%	7.2%	11%	12.5%	10.8%
US GOVT CONTRIBUTION	6.9%	7.2%	9.8%	8.3%	8.5%

Source: U.S. Department of Commerce

(Text continued from page 3)

State Payroll and Benefits

Real state labor costs (in 1988 dollars) rose sharply and steadily from about $238 million in fiscal 1970 to $885 million in 1986, as both the numbers of state employees and wage and benefit levels rose. (See the top left graph on the facing page.) The severe recession of the late 1980s forced layoffs and held down wages, but labor costs began rising again in fiscal 1988.

It's important to consider not only the total number of state workers but also the number in relation to the Alaska population. In fiscal 1989 the state had more employees than in the budget-cutting year of 1987, but still about 3 percent fewer than in the peak year of 1986. And as the graph in the middle of the facing page shows, there were about 5 percent fewer employees *per 10,000 population* than in the peak year of 1984.

The table at the bottom of page 14 summarizes some of the reasons why state employment grew in the 1980s. It underscores the fundamental point that government services require government employees. Because of the many new state programs added since 1980, state employment in traditional government programs has declined as a percentage of population.

The growth in labor costs at the end of the decade was primarily the result of a growing number of state employees and higher benefit costs rather than wage hikes. The average wage of state workers changed little in the late 1980s. But substantial wage increases in the period from 1977 to 1987 left average Alaska state wages 25 percent above the national average in 1987. There are of course differences in wages among occupations, and the mix of occupations in the state work force influences the level of the average. We don't know how the mix of occupations among Alaska state workers may differ from the mix in other states.

At the end of the 1980s the rising costs of state benefits, which add 33 percent to employee costs over and above payroll, got a lot of attention. Costs for employee health insurance (which make up 29 percent of benefits) nearly doubled between 1985 and 1989, causing the state to look for ways of holding down premiums. Through negotiations with employee unions and other measures, the state was able in 1990 to reduce monthly health insurance costs per employee by about 10 percent.

The other big benefit cost is for retirement plans (30 percent of benefits). State employees and the government both contribute to retirement plans. In 1987 employee and government contributions to Alaska state and local retirement plans amounted to 16.5 percent of state and local payroll, compared with about 12 percent nationally. Both Alaska employee and government contributions are above the national average.

Table 1. Summary of 10 Largest Transfer Programs

Total 1989 Expenditures: $1.4 billion
(Gen. Fund 59%; PF 31%; Fed. 9%)

Real Increase In Transfer Payments, 1980-89 (In 1988 $):
Total Transfers: +242%
Gen. Fund Transfers: +138%

Projected Growth in Gen. Fund Transfer Payments by 2000 (In 1988$) (with no program changes):
Additions* $160 million

Percentage Change in Program Size, 1980-89 (In 1988$):

PF Dividend	**	Med Asst.	+ 148%
Power Cost Eq.	**	School Foundation	+ 116%
Muni. Asst.	**	Pub. Asst.	+ 81%
School Debt Reim.	+ 249%	Pupil Trans.	+ 29%
Longevity Bonus	+ 207%	Revenue Shar.	+ 17%

(State Population Growth +27%)

Programs That Didn't Exist Before 1980: 3 of 10

Programs Based on Need: 5 of 10

Programs Unique to Alaska: 5 of 10

Program Expend. Cut Between 1985 and 1989: 5 of 10

* (Does not take into account phaseout of School Debt Reimbursement program; see page 8)

**(Programs didn't exist in 1980)

Conclusions

Reducing or at least containing transfers and labor costs offers the best hope for cutting state spending in the leaner times ahead. But any cost-cutting moves will be difficult and complicated. Table 1 summarizes salient points about the 10 largest state transfer programs. From the table and earlier material we conclude:

1. **Transfer programs are big and growing.** Between 1970 and 1989 transfer programs increased from 26 to 44 percent of the total operating budget. Unless capped, the largest transfers will add another $160 million (in inflation-adjusted dollars) to state general fund spending by 2000. The largely uncontrollable and escalating costs of state participation in such federal transfer programs as Medicaid will require offsetting reductions in other programs just to keep the budget at the current level.

2. **Popular state transfer programs that distribute part of the state's oil wealth without regard to need or traditional public purposes will increasingly compete with longstanding government programs as oil revenues decline.** Last year the state spent almost as much for the Permanent Fund Dividend program ($440 million) as it did for the state's largest traditional transfer program, the School Foundation program ($456 million). As the state's fiscal gap

widens, continuation of Alaska's unique transfer programs that are not based on need will begin to undermine the traditional role of Alaska state government.

3. **Few of the state's transfer programs were cut significantly in the late 1980s, and most of those that were have begun growing again.** In most cases the programs began growing again because the number of beneficiaries increased; that resurgent growth illustrates the difficulty of holding state spending to current levels without program policy changes.

4. **Only half the state's largest transfer programs are based on financial need.** The programs for the poorest Alaskans, the public assistance and the medical assistance programs, accounted for just 15 percent of all the money paid out under the 10 largest transfer programs.

5. **Across-the-board cuts in transfer programs would put a disproportionate burden on low-income Alaskans.** Beneficiaries of state transfer programs range from school children to those over 65 with low incomes. To avoid imposing unintended hardships, state officials will need to consider the basic government purposes each program serves and how such purposes would be affected by policy changes or spending cuts.

6. **A partial alternative to reducing or eliminating services is designing a more effective or efficient delivery system.** Beneficiaries of many of Alaska's transfer programs have little incentive to contain costs. Restructuring programs to create incentives for savings and to require some contribution from beneficiaries who are able to pay could make the programs more efficient and less costly.

The School Foundation program, because it is the state's largest transfer program and because providing for public education is a constitutional obligation of the state, is a prime candidate for re-examining the efficiency and effectiveness of service delivery.

7. **Cost-cutting alternatives would all reduce economic activity by taking purchasing power out of the economy.** While the state cannot avoid the negative social and economic effects of cost-cutting, it can take actions and adjust policies to reduce or mitigate them. Similarly, planned and phased reductions could enable beneficiaries to anticipate and prepare for reduced aid.

8. **State labor costs have historically grown as Alaska's population grew, and will tend to do so in the future.** If Alaska simply adds workers as the population grows over the next decade, increased labor costs will widen the projected fiscal gap. To avoid reducing or eliminating services requires looking for ways to deliver them more efficiently.

9. **State labor costs are back on the rise.** State officals considering how to contain labor costs should look at components of those costs:

a. *Wages*—While the average wage of state workers did not increase in recent years, in 1987 it remained about 25 percent above the U.S. average, after a cost-of-living adjustment.

b. *Numbers of workers*—The absolute number of state workers and the number per 10,000 population both increased in the late 1980s.

c. *Benefits*—Benefits make up 25 percent of labor costs. Retirement contributions of Alaska's public employees and state and local governments remain 38 percent above the national average. The state pays 100 percent of the costs of state employee health insurance. Those costs nearly doubled betweeen 1985 and 1989. The state was able to reduce health insurance premiums about 10 percent in 1990, but because of the rising costs of medical care, the upward trend in these payments will be hard to offset.

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